

SETTLEMENT AGREEMENT

THE PARTIES

This Settlement Agreement ("Agreement") is entered into this 5th day of June 2009. The parties to this Agreement (hereinafter "the Parties") are the State of Tennessee (hereinafter "Tennessee"), the United States of America, acting through the United States Department of Justice and on behalf of the Office of Inspector General ("OIG") of the Department of Health and Human Services ("HHS") (collectively the "United States"); Jeanne F. Mayes (the "Relator"); Kindred Healthcare, Inc.; Kindred Healthcare Operating, Inc.; Kindred Hospitals Limited Partnership, LTD.; Kindred Nursing Centers Limited Partnership; and Kindred Pharmacy Services, Inc. (collectively, "Kindred"); PMC Pharmacy Services; and PharMerica Healthcare Pharmacy, LLC (collectively "PharMerica"); and all of whom are collectively the "Parties," through their authorized representatives.

PREAMBLE

As a preamble to this Agreement, the Parties agree to the following:

A. Kindred Healthcare, Inc., a Delaware corporation and national healthcare services company based in Louisville, Kentucky, through its subsidiaries Kindred Hospitals Limited Partnership d/b/a Kindred Pharmacy Services and/or Kindred Pharmacy Services, Inc., during the period from 2003 through 2006 conducted business throughout the State of Tennessee, providing pharmaceutical supplies and drugs to long term care patients in skilled nursing facilities and submitting claims for such drugs and supplies through the TennCare, Medicaid and Medicare programs. Kindred was authorized to provide pharmaceutical services and submit claims to TennCare pursuant to a Pharmacy Participation Agreement between Kindred and its

predecessor Vencor Operating, Inc. a/k/a Kindred Healthcare Operating, Inc. d/b/a Vencor Pharmacy Services.

B. Relator Jeanne F. Mayes is an individual and resident of the State of Tennessee. On February 11, 2005, Relator filed a *qui tam* action in the United States District Court for the Eastern District of Tennessee captioned *United States ex rel. Jeanne F. Mayes and State of Tennessee ex rel. Jeanne F. Mayes v. Kindred Healthcare, Inc, et al.*, No. 3:05-CV-89. Prior to filing the complaint, the Relator, a certified pharmaceutical technician, had been employed by Kindred Pharmacy Services as a billing clerk primarily involved in submitting to, and handling rejected claims from, TennCare for medications supplied by Kindred's Knoxville pharmacy. In performing her duties as a billing clerk, Relator was familiar with Kindred's computer billing system and improper billing practices resulting in overpayments by TennCare. Tennessee is filing contemporaneously with this settlement a notice of its election to intervene in part and to decline in part in the action filed by the Relator. The United States has previously declined to intervene, but for good cause shown, also files contemporaneously with this settlement a motion and notice of its election to intervene in part.

C. The Agreement resolves the civil claims of Tennessee and the United States arising from or based on the conduct alleged in sections (i) through (iv) (the "Covered Conduct").

(i) Tennessee and the United States contend that from February 1, 2003 through December 31, 2005, Kindred submitted monthly claims for payment to the Medicaid program in Tennessee, known as TennCare, for prescription drugs consumed by TennCare patients at nursing homes and long term care facilities located in Tennessee.

(ii) Tennessee and the United States further contend that the claims for payment submitted by Kindred during this period contained false information. Specifically, Kindred knowingly or recklessly demanded payment for pharmaceuticals that were neither delivered to the facilities nor consumed by TennCare patients.

(iii) Tennessee and the United States further contend that TennCare relied upon these claims in paying money to Kindred to which it was not entitled.

(iv) Accordingly, Tennessee and the United States contend that the activities alleged in Paragraph D (i) through (iv) constituted false claims to the TennCare program.

D. This Agreement is neither an admission of liability by Kindred and PharMerica nor a concession by either Tennessee or the United States that its claims are not well founded.

E. To avoid the delay, uncertainty, inconvenience, and expense of protracted litigation of the above claims, the Parties have reached a full and final settlement pursuant to the Terms and Conditions below.

III. TERMS AND CONDITIONS

1. PharMerica agrees to pay to Tennessee and the United States, collectively, the total sum of One Million Three Hundred Seven Thousand Seven Hundred Fifty Two Dollars (\$1,307,752) (the "Settlement Amount"), to be paid as follows:

a. PharMerica will make a payment in the amount of \$588,488.40 to Tennessee within 30 days of the Effective Date of this Agreement. All payments made by PharMerica to Tennessee will be made by electronic funds transfer pursuant to written instructions to be provided by the Office of the Attorney General for the State of Tennessee; and

b. PharMerica will make a payment to the United States in the amount of \$719,263.60 within 30 days of the Effective Date of this Agreement. All payments made by

PharMerica to the United States will be made by electronic funds transfer pursuant to written instructions to be provided by the United States Department of Justice.

2. Tennessee and the United States agree to pay a portion of the Settlement Amount to the Relator, as follows:

a. Contingent upon Tennessee receiving the Settlement Amount from Kindred and as soon as feasible after receipt, Tennessee agrees to pay \$100,043.03 to Relator by electronic funds transfer pursuant to written instructions provided by counsel for the Relator; and

b. Contingent upon the United States receiving the Settlement Amount from PharMerica and as soon as feasible after receipt, the United States agrees to pay \$122,274.81 to the Relator by electronic funds transfer pursuant to written instructions provided by counsel for the Relator.

3. PharMerica shall pay to the Relator on the effective date of this agreement the sum of \$58,364.54 for her attorney's fees and costs.

4. Subject to the exceptions in Paragraph 6 below, in consideration of the obligations of PharMerica set forth in this Agreement, conditioned upon PharMerica's full payment of the Settlement Amount, Tennessee (on behalf of itself, its officers, agents, agencies, and departments) agrees to release Kindred and PharMerica, together with its current and former parent corporations, each of its subsidiaries, brother or sister corporations, divisions, current or former owners, officers, directors, employees, agents, and affiliates, and the successors and assigns of any of them (the "Kindred and PharMerica Released Parties"), from any civil or administrative monetary claim Tennessee has or may have for the Covered Conduct under the Tennessee Medicaid False Claims Act, Tenn. Code Ann. § 71-5-181 *et seq.* or the common law theories of payment by mistake, unjust enrichment, conversion and fraud. Tennessee does not

have the authority, and does not intend, to release Kindred or PharMerica from any claims or actions which may be asserted by private payors or insurers, including those that are paid by TennCare on a capitated basis.

5. Subject to the exceptions in Paragraph 6 below, in consideration of the obligations of Kindred and PharMerica set forth in this Agreement, and conditioned upon PharMerica's full payment of the Settlement Amount, the United States (on behalf of itself, its officers, agents, agencies, and departments) agrees to release the Kindred and PharMerica Released Parties, from any civil or administrative monetary claim the United States has or may have for the Covered Conduct under the False Claims Act, 31 U.S.C. §§ 3729-3733; the Civil Monetary Penalties Law, 42 U.S.C. § 1320a-7a; the Program Fraud Civil Remedies Act, 31 U.S.C. §§ 3801-3812; or the common law theories of payment by mistake, unjust enrichment, conversion, and fraud.

6. In consideration of the obligations of Kindred and PharMerica set forth in this Agreement, conditioned upon PharMerica's full payment of the Settlement Amount, Tennessee agrees to release and refrain from instituting, directing, or maintaining any administrative action seeking exclusion from TennCare, and other State health care programs (as defined in Tenn. Comp. R. & Regs. 1200-13-12-.08) against Kindred and PharMerica for the Covered Conduct, except as reserved in Paragraph 8 below, and as reserved in this Paragraph. Tennessee expressly reserves all rights to comply with any statutory obligations to exclude Kindred from TennCare and other State health care programs based upon the Covered Conduct. Tennessee expressly reserves all rights to comply with any mandatory statutory obligations to exclude Kindred from TennCare and other State health care programs based upon the Covered Conduct. Nothing in

this Paragraph precludes Tennessee from taking action against entities or persons, or for conduct and practices for which claims have been reserved in Paragraph 8 below.

7. OIG-HHS expressly reserves all rights to institute, direct, or to maintain any administrative action seeking exclusion against Kindred and/or PharMerica, and/or its officers, directors, and employees from Medicare, Medicaid, and all other Federal health care programs (as defined in 42 U.S.C. § 1320a-7b(f)) under 42 U.S.C. § 1320a-7(a) (mandatory exclusion), or 42 U.S.C. § 1320a-7(b) or 42 U.S.C. 1320a-7a (permissive exclusion).

8. Notwithstanding any term of this Agreement, specifically reserved and excluded from the scope and terms of this Agreement as to any entity or person (including Kindred and PharMerica) are the following:

- a. Any civil, criminal, or administrative liability arising under Title 26, U.S. Code (Internal Revenue Code);
- b. Any criminal liability;
- c. Except as explicitly stated in this Agreement, any administrative liability, including mandatory exclusion from Federal or state health care programs;
- d. Any liability to TennCare (or its agencies) for any conduct other than the Covered Conduct;
- e. Any liability based upon such obligations as are created by this Agreement; and
- f. Any liability for express or implied warranty claims or other claims for defective or deficient products or services, including quality of goods and services.

9. Kindred and PharMerica waive and shall not assert any defenses Kindred or PharMerica may have to any criminal prosecution or administrative action relating to the Covered Conduct, which defenses may be based in whole or in part on a contention that, under the Double Jeopardy Clause in the Fifth Amendment of the Constitution, or under the Excessive Fines Clause in the Eighth Amendment of the Constitution, this Agreement bars a remedy sought in such criminal prosecution or administrative action. Nothing in this Paragraph or any other provision of this Agreement constitutes an agreement by Tennessee or the United States concerning the characterization of the Settlement Amount for purposes of the Internal Revenue laws, Title 26 of the United States Code.

10. Kindred and PharMerica fully and finally release Tennessee and the United States, and their respective agencies, employees, servants, and agents from any claims (including attorney's fees, costs, and expenses of every kind and however denominated) that Kindred and PharMerica have asserted, could have asserted, or may assert in the future against Tennessee and the United States, their respective agencies, employees, servants, and agents related to the Covered Conduct and Tennessee's and the United States' investigation and prosecution thereof. Kindred and PharMerica also fully and finally release the Relator and her attorneys from any claims (including attorney's fees, costs, and expenses of every kind and however denominated) that Kindred and PharMerica have asserted, could have asserted, or may assert in the future against the Relator, and/or her attorneys, related to the Covered Conduct and the Relator's investigation and prosecution thereof.

11. The Relator and her respective heirs, successors, attorneys, agents, and assigns agree not to object to this Agreement and agree and confirm that this Agreement is fair, adequate, and reasonable under all the circumstances, pursuant to 31 U.S.C. § 3730(c)(2)(B) and,

conditioned upon receipt of the Relator's share, the Relator, for herself, individually, and for her respective heirs, executors, successors, agents, and assigns, fully and finally releases, waives, and forever discharges Tennessee and the United States, and their respective officers, agents, and employees, from any claims arising from or relating to 31 U.S.C. § 3730 and Tenn. Code Ann. §71-5-181 *et seq.*; from any claims arising from the filing of the Civil Action; and from any other claims for a share of the Settlement Amount; and in full settlement of any claims the Relator may have under this Agreement. This Agreement does not resolve or in any manner affect any claims the United States has or may have against the Relator arising under Title 26, U.S. Code (Internal Revenue Code), or any claims arising under this Agreement.

12. Conditioned upon receipt of the payment described in Paragraph 2, the Relator, for herself, and for her respective heirs, executors, successors, attorneys, agents, and assigns, agrees to release the Kindred and PharMerica Released Parties, its officers, agents, and employees, from any liability to Relator arising from the filing of the Civil Action, or under 31 U.S.C. § 3730(d) or Tenn. Code Ann. §71-5-181 *et seq.* for expenses or attorney's fees and costs.

13. The Settlement Amount shall not be decreased as a result of the denial of claims for payment now being withheld from payment by any TennCare or Medicare carrier or intermediary, or any other state payer, and Kindred shall not resubmit to any TennCare or Medicare carrier or intermediary, or any other state payer, any previously denied claims related to the Covered Conduct, and shall not appeal any such denials of claims.

14. Kindred and PharMerica agree to the following, if appropriate:

a. Unallowable Costs Defined: that all costs (as defined in the Federal Acquisition Regulation, 48 C.F.R. § 31.205-47; and in Titles XVIII and XIX of the Social Security Act, 42 U.S.C. §§ 1395-1395hhh and 1396-1396v; and the regulations and official

program directives promulgated thereunder) incurred by or on behalf of Kindred and PharMerica, their present or former officers, directors, employees, shareholders, and agents in connection with the following shall be “Unallowable Costs” on government contracts and under the Medicare Program, Medicaid Program, and TennCare program:

- (1) the matters covered by this Agreement;
- (2) Tennessee’s and the United States’ audit(s) and civil investigation(s) of the matters covered by this Agreement;
- (3) Kindred and PharMerica’s investigation, defense, and corrective actions undertaken in response to Tennessee’s and the United States’ audit(s) and investigation(s) of the matters covered by this Agreement;
- (4) Kindred and PharMerica’s investigation, defense, and corrective actions undertaken in response to Tennessee’s and the United States’ audit(s) and civil investigation(s) in connection with the matters covered by this Agreement (including attorney’s fees);
- (5) the negotiation and performance of this Agreement;
- (6) the payment PharMerica makes to Tennessee and the United States pursuant to this Agreement and any payments that PharMerica may make to Relator, including costs and attorneys fees;

b. Future Treatment of Unallowable Costs: These Unallowable Costs shall be separately determined and accounted for by Kindred and PharMerica, and Kindred and PharMerica shall not charge such Unallowable Costs directly or indirectly to any contracts with the United States or any State Medicaid program, or seek payment for such Unallowable Costs through any cost report, cost statement, information statement, or payment request submitted by

Kindred, PharMerica, or any of their subsidiaries or affiliates to the Medicare, Medicaid, or TennCare Programs.

c. Treatment of Unallowable Costs Previously Submitted for Payment:

Kindred and PharMerica further agree that within 90 days of the Effective Date of this Agreement it shall identify to applicable Medicare and TRICARE fiscal intermediaries, carriers, and/or contractors, and Medicaid and FEHBP fiscal agents, any Unallowable Costs (as defined in this Paragraph) included in payments previously sought from the United States, or any State Medicaid program, including, but not limited to, payments sought in any cost reports, cost statements, information reports, or payment requests already submitted by Kindred, PharMerica, or any of their subsidiaries or affiliates, and shall request, and agree, that such cost reports, cost statements, information reports, or payment requests, even if already settled, be adjusted to account for the effect of the inclusion of the unallowable costs. Kindred and PharMerica agree that the United States, at a minimum, shall be entitled to recoup from Kindred or PharMerica any overpayment plus applicable interest and penalties as a result of the inclusion of such Unallowable Costs on previously-submitted cost reports, information reports, cost statements, or requests for payment. Any payments due after the adjustments have been made shall be paid to the United States pursuant to the direction of the Department of Justice and/or the affected agencies. The United States reserves its rights to disagree with any calculations submitted by Kindred, PharMerica, or any of their subsidiaries or affiliates on the effect of inclusion of Unallowable Costs (as defined in this Paragraph) on Kindred, PharMerica, or any of their subsidiaries or affiliates' cost reports, cost statements, or information reports.

d. Nothing in this Agreement shall constitute a waiver of the rights of the United States to audit, examine, or re-examine Kindred and PharMerica's books and records to

determine that no Unallowable Costs have been claimed in accordance with the provisions of this Paragraph.

15. This Agreement is intended to be for the benefit of the Parties only. The Parties do not release any claims against any other person or entity, except to the extent provided for in Paragraph 16 below.

16. Kindred and PharMerica waive and shall not seek payment for any of the health care billings covered by this Agreement from any health care beneficiaries or their parents, sponsors, legally responsible individuals, or third party payors based upon the claims defined as Covered Conduct.

17. Kindred and PharMerica warrant that they have reviewed their financial situation and that it currently is solvent within the meaning of 11 U.S.C. §§ 547(b)(3) and 548(a)(1)(B)(ii)(I), and shall remain solvent following payment to Tennessee and the United States of the Settlement Amount. Further, the Parties warrant that, in evaluating whether to execute this Agreement, they (a) have intended that the mutual promises, covenants, and obligations set forth constitute a contemporaneous exchange for new value given to Kindred and PharMerica, within the meaning of 11 U.S.C. § 547(c)(1); and (b) conclude that these mutual promises, covenants, and obligations do, in fact, constitute such a contemporaneous exchange. Further, the Parties warrant that the mutual promises, covenants, and obligations set forth herein are intended to and do, in fact, represent a reasonably equivalent exchange of value that is not intended to hinder, delay, or defraud any entity to which Kindred or PharMerica was or became indebted, on or after the date of this transfer, all within the meaning of 11 U.S.C. § 548(a)(1).

18. Upon receipt of the payments described in Paragraph 1, above, Tennessee, the United States and Relator shall promptly sign and file in the Civil Action a Joint Stipulation of Dismissal with prejudice of the Civil Action pursuant to the terms of the Agreement.

19. Each Party to this Agreement shall bear its own legal and other costs incurred in connection with this matter, including the preparation and performance of this Agreement.

20. Kindred and PharMerica represent that this Agreement is freely and voluntarily entered into without any degree of duress or compulsion whatsoever and that Kindred and PharMerica understand their right to advice of counsel concerning this Agreement.

21. This Agreement is governed by the laws of the United States and Tennessee. The Parties agree that the exclusive jurisdiction and venue for any dispute arising between and among the Parties under this Agreement is the United States District Court for the Eastern District of Tennessee.

22. The individuals signing this Agreement on behalf of Kindred and PharMerica represent and warrant that they are authorized by Kindred and PharMerica to execute this Agreement. The Tennessee signatory represents that he is signing this Agreement in his official capacity and that he is authorized to execute this Agreement. The United States signatories represent that they are signing this Agreement in their official capacities and that they are authorized to execute this Agreement.

23. This Agreement may be executed in counterparts, each of which constitutes an original and all of which constitute one and the same Agreement.

24. This Agreement constitutes the complete agreement between the Parties and may not be amended except by written consent of the Parties.

25. For purposes of construction, this Agreement shall be deemed to have been drafted by all Parties to this Agreement and shall not, therefore, be construed against any Party for that reason in any subsequent dispute.

26. This Agreement is binding on Kindred and PharMerica's successors, transferees, heirs, and assigns.

27. This Agreement is binding on Relator's successors, transferees, heirs, and assigns.

28. All Parties consent to Tennessee's and the United States' disclosure of this Agreement, and information about this Agreement, to the public.

29. This Agreement is effective on the date of signature of the last signatory to the Agreement (Effective Date of this Agreement). Facsimiles of signatures shall constitute acceptable, binding signatures for purposes of this Agreement.

THE STATE OF TENNESSEE

DATED: 6-3-09

BY:



ROBERT E. COOPER, JR.
ATTORNEY GENERAL & REPORTER

THE UNITED STATES OF AMERICA

JAMES R. DEDRICK
UNITED STATES ATTORNEY
Eastern District of Tennessee

DATED: _____

BY: _____

Elizabeth S. Tonkin
Assistant U.S. Attorney

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DATED: _____

BY: _____
ROBERT E. COOPER, JR.
ATTORNEY GENERAL & REPORTER

THE UNITED STATES OF AMERICA

JAMES R. DEDRICK
UNITED STATES ATTORNEY
Eastern District of Tennessee


DATED: May 22, 2009

BY: _____

Elizabeth S. Tonkin
Assistant U.S. Attorney

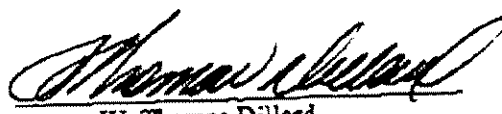
UNITED STATES DEPARTMENT OF
HEALTH AND HUMAN SERVICES
Office of Inspector General

DATED: 6/5/09


BY: 
GREGORY E. DEMSKE
Assistant Inspector General for Legal Affairs
Office of Counsel to the Inspector General

KINDRED PARTIES

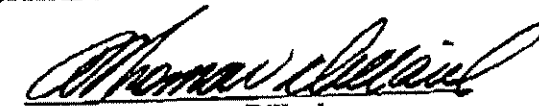
KINDRED HEALTHCARE, INC.

DATED: May 22, 09 BY: 
W. Thomas Dillard
Its Attorney

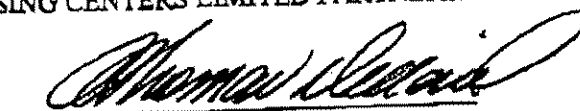
KINDRED HEALTHCARE OPERATING, INC.

DATED: May 22, 09 BY: 
W. Thomas Dillard
Its Attorney

KINDRED HOSPITAL LIMITED PARTNERSHIP, LTD.

DATED: May 22, 09 BY: 
W. Thomas Dillard
Its Attorney

KINDRED NURSING CENTERS LIMITED PARTNERSHIP

DATED: May 22, 09 BY: 
W. Thomas Dillard
Its Attorney

UNITED STATES DEPARTMENT OF
HEALTH AND HUMAN SERVICES
Office of Inspector General


DATED: _____

BY: _____


GREGORY E. DEMSKE
Assistant Inspector General for Legal Affairs
Office of Counsel to the Inspector General

KINDRED PARTIES

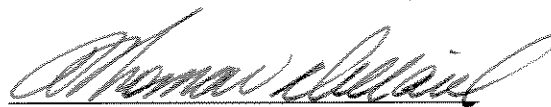
KINDRED HEALTHCARE, INC.

DATED: May 22, 09 BY: 
W. Thomas Dillard
Its Attorney

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Its Attorney

KINDRED NURSING CENTERS LIMITED PARTNERSHIP


DATED: May 22, 09 BY: 
W. Thomas Dillard
Its Attorney

KINDRED PHARMACY SERVICES, INC.

DATED: May 22, 09 BY: 
W. Thomas Dillard
Its Attorney

PHARMERICA PARTIES

PMC PHARMACY SERVICES, INC.

DATED: May 22, 09 BY: 
W. Thomas Dillard
Its Attorney

PHARMERICA HEALTHCARE PHARMACY, LLC

DATED: May 22, 09 BY: 
W. Thomas Dillard
Its Attorney

RELATOR

DATED: _____ BY: _____
Jeanne F. Mayes

DATED: _____ BY: _____
David H. Burkhalter
Ronald A. Rayson
Burkhalter, Rayson & Assoc.
Counsel for Relator

KINDRED PHARMACY SERVICES, INC.

DATED: _____

BY: _____
W. Thomas Dillard
Its Attorney

PHARMERICA PARTIES

PMC PHARMACY SERVICES, INC.

DATED: _____

BY: _____
W. Thomas Dillard
Its Attorney

PHARMERICA HEALTHCARE PHARMACY, LLC

DATED: _____

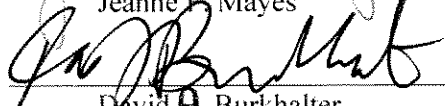
BY: _____
W. Thomas Dillard
Its Attorney

RELATOR

DATED: 28 MAY 09

BY: 
Jeanne F. Mayes

DATED: 28 May 09

BY: 
David H. Burkhalter
Ronald A. Rayson
Burkhalter, Rayson & Assoc.
Counsel for Relator